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Tullis Russell v. *Inveresk*

This decision in *Tullis Russell Papermakers Ltd* v. *Inveresk Ltd*,[1] forms but one judgment in an inter-related set of claims, one aspect of which (on the so-called remedy of "retention", *ie* the justified withholding of performance in response to another contracting party's breach of contract) has already been the subject of a decision of the Supreme Court.[2]

The principal matter in this judgment of Lord Drummond Young, sitting in the Outer House of the Court of Session, was the assessment of the quantum of damages due by the defenders, Inveresk, for alleged breaches of contract. The judgment is of particular interest in its discussion of the valuation of trading losses due to damage to the goodwill attached to a business brand. Quantifying loss in such cases is usually a difficult exercise, not simply because of the ephemeral quality of goodwill but also because of the difficulty of demonstrating what precisely the counterfactual outcome would have been in the absence of breach of the contract. A legitimate question arises as to whether anything other than a highly speculative figure for lost profits due to the harm done to goodwill can be arrived at or whether some method (and if so, which) may provide a reasonably accurate assessment of the actual losses suffered.

It should at the outset be noted that, this being a Scottish action, the settled distinction in English law between general and special damages did not feature in the judgment. In Scots law, no such specific distinction has been drawn,[3] the courts instead taking the view that, in any breach of contract action, all losses for which damages are sought must be enumerated in the written pleadings, each such item of loss must be quantified by the pursuer, and, in due course, a reasonable method of assessment for the specific quantum of loss claimed must be presented to the court at the relevant hearing.[4] Lost profits due to a general reduction in trade as a result of harm to goodwill can therefore be included as a head of damages in a Scottish action, and the inclusion of such a head of damage has not in Scotland historically raised the sort of theoretical difficulties that troubled the King's Bench Division in *Aerial Advertising* v. *Batchelor's Peas*.[5] Despite the absence of a general/special damages division in Scots law, one could, as a matter of fact, draw a distinction between those Scottish cases in which a specific pecuniary loss was claimed from those in which a general reduction in trading profits was claimed, even if such a distinction has not given rise to separate rules for the treatment of these two categories of claim. Drawing such a factual distinction can be argued to be useful because the method for quantifying loss approved by Lord Drummond Young in *Tullis Russell* will only need to be utilised where general trading losses are claimed. That being the case, it can be argued that the significance of *Tullis Russell* to both Scots as well as to English law is that it provides a more sophisticated methodology (the 'portfolio method' described below) for quantifying lost general trading profits as a result of damage to business goodwill than has hitherto been applied. Whereas the assessment of damages by Atkinson J in *Aerial Advertising* was suggested by the court to offer only a rough estimate of losses, the 'portfolio method' is likely to appeal to courts in the future as offering a much more accurate measurement for quantifying lost general business profits.

Prior to the *Tullis Russell* decision, there had been little in recent years by way of reported Scottish decisions on the calculation of goodwill (and consequent damage to goodwill), the

[1] [2010] CSOH 148 (Ct Sn: OH).
[2] *Inveresk Plc v Tullis Russell Papermakers Ltd* [2010] UKSC 19; 2010 SCLR 396; 2010 SLT 941 .
[3] This may be indicated by consulting the standard academic work on Scots contract law, W M McBryde's *The Law of Contract in Scotland*, 3rd ed (2007). There are only two mentions of the term 'special damages' in the entire work, and both of these are passing references to the English judgments of *Wadsworth* v. *Lydall* [1981] 1 WLR 598 and *President of India* v. *La Pintada Cia Navigacion S.A.* [1985] AC 104.
[4] In addition, the rules concerning causation of loss and remoteness of damage applicable in an English claim are equally applicable in Scottish actions.
[5] [1938] 2 All ER 788.

comment by one judge in a previous case that "[v]aluation of it is not easy"[6] being very reminiscent of the concerns raised by Atkinson J which resulted in his rough and ready attempt at quantification. As *McGregor on Damages* explains, a claim for damages for pecuniary loss flowing from damage to business reputation has only been permitted by the courts in restricted instances, the characteristic linking such recognised instances being that "the loss was particularly contemplated by the parties".[7] Claiming for such a head of loss resulting from damage to goodwill was not problematic in *Tullis Russell*, as the contract of sale of the branded goods in question had specifically included the goodwill associated with such brand: loss to goodwill was thus evidently within the class of loss that might reasonably have been contemplated by the parties as likely to arise in the event of breach of the contractual relationship.

The specific facts of the case were that Tullis Russell manufactured a specific type of coated solid board named 'Trucard', while Inveresk (in receivership by the time of the litigation) manufactured a similar type of board called 'Gemini'. In 2005, Tullis Russell had agreed to purchase the Gemini brand and its goodwill, together with related customer information and other assets, it being agreed that, for a few months following the purchase, Inveresk would continue to manufacture Gemini under licence from Tullis Russell. The overall arrangement was embodied in two contracts, the Asset Purchase Agreement and the Services Agreement. Following the purchase, it transpired that the Gemini board manufactured and distributed by Inveresk was defective. It also became apparent that Inveresk had been dealing with customer complaints about such defects in a hostile manner, one likely to antagonise and alienate customers. The resulting sales of Gemini were much lower than Tullis Russell had expected, and they sued Inveresk for breach of contract, founded upon both the defects in the Gemini board as well as the antagonistic behaviour of Inveresk towards customers (behaviour which Tullis Russell alleged could be 'regarded as striking at the fundamental purpose of the parties' transaction'[8]). Both breaches were argued to have affected the goodwill attached to the Gemini brand, causing some customers to cease doing business with the pursuers entirely and other customers to reduce their level of orders or to decide not to transfer their business from the defenders to the pursuers. Both breaches were thus argued to have made a contribution to a cumulative loss, one presented by Tullis Russell as a 'global claim'.[9] A global claim has previously been described judicially[10] as one

> 'in which the individual causal connections between the events giving rise to the claim and the items of loss and expense making up the claim are not specified, but the totality of the loss and expense is said to be a consequence of the totality of the events giving rise to the claim'.

Such claims have typically (though not exclusively) been advanced in construction cases, and are permitted so long as there is no significant cause of the global losses other than the behaviour of the party shown to be in breach.[11] The benefit to Tullis Russell of mounting such a global claim was that they were not required to distinguish the extent of their losses due to the defective manufacturing by the defenders from the extent of their losses due to the defenders' antagonistic treatment of customers, a distinction which would likely have been impossible to draw. While the defenders tried to argue that a global claim was unacceptable because a not inconsiderable portion of the loss was attributable not to their conduct but to the merger of the companies,[12] Lord Drummond Young dismissed such a suggestion, holding that the significant

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[6] *Per* Sheriff Peter Anderson, in *Gray* v. *Dickson*, Sheriffdom of Tayside, Central & Fife at Perth, 10 August 2007 (Ref: A1116/05)(this judgment is available online at http://www.scotcourts.gov.uk/opinions/A1116_05.html).
[7] *McGregor on Damages*, 18th ed (2009), [2.028].
[8] At [49].
[9] At [65-66].
[10] *John Doyle Construction Ltd* v. *Laing Management (Scotland) Ltd* 2004 SCLR 872, [4] (Lord Drummond Young).
[11] See, for an example of such a claim in a construction context, *Merton LBC* v. *Stanley Hugh Leach Ltd* (1986) 32 BLR 51; 2 Const LJ 189.
[12] See at [66-71].

causes of the loss were the two breaches of contract by Inveresk. Each such breach had contributed to a single, overall loss suffered by Tullis Russell.[13]

Turning to the heart of the judgment – the assessment of the business losses suffered as a result of damage to the brand's goodwill – the alleged loss of profit was due to the behaviour of multiple existing clients (and potential clients which failed to materialise), so that uncertainty existed both as to whether specific contracts had been lost and, if they had, as to the value of such contracts. As remarked earlier, in such cases any attempt to determine counterfactual causation of loss can appear highly speculative. A number of questions may present themselves to a court dealing with such a case. Can a claimant in fact show, to the required level of proof (on the balance of probabilities), that, but for breach *x*, loss *y* would not have occurred? In posing this question (and bearing in mind the absence of a general/special damages distinction in Scots law), must it be asked individually of each established client (as well as of potential lost clients), or is some cumulative assessment to be attempted? Should evidence be taken from the clients themselves, or can one ask industry experts for an assessment? If causation cannot be demonstrated to the required level of proof, can loss of a chance (of securing contracts which were not won) be claimed, and, if so, at what level is the chance lost to be assessed? Most of these questions were addressed by Lord Drummond Young, though the lost chance issue was, as will be seen, thought not to arise.

Despite the lack of a recognised distinction between special and general damages in Scots law, the Scottish courts in effect allow what could be called general damages claims, by permitting claims for general harm to business. These do no not require specific losses to be connected to individual customers or potential customers. Rather, the courts are willing in principle to accept the testimony of expert witnesses concerning alleged trading losses, and will assess the reasonableness of the methodology suggested by such witnesses: if a witness is deemed to have adopted a reasonable method, based upon sound assumptions, then the figures suggested by that witness will usually be accepted without an attempt by the court to substitute its own figures. As was remarked judicially in another relatively recent Scottish judgment on damages for general trading losses as a result of breach of contract:[14]

> 'Although it is possible for the court to make an assessment, in the light of the evidence, of how realistic or otherwise certain of the assumptions made by the expert witnesses may have been … the court lacks the expertise in valuation necessary to fix values in respect of every element in a calculation of that kind.'

In the case before him, Lord Drummond Young, faced with the testimony of a principal expert witness led by each side, preferred the methodology of the witness led by Tullis Russell (a Dr Cuchra). Dr Cuchra's suggested methodology for assessing loss was based upon taking a portfolio of Tullis Russell's customers and comparing the actual profits derived from this portfolio with the counterfactual profits that would have arisen in the absence of the breaches (it being suggested that such profits should be determined on the basis of tonnage and margins).[15] The suggested portfolio of customers was a wide one, Dr Cuchra being, in principle, of the opinion that "the analysis should be performed against the whole portfolio of customers acquired by the pursuers, without exclusion".[16]

This 'portfolio method' was suggested as preferable[17] because: (i) it had the ability to capture commercial and economic linkages between different customers, including the implicit impact of brand and reputation; (ii) it was characterised by better statistical properties than the

[13] At [92] (on the quality of the board), [127] (on dealings with customers) and [128] (summarising both breaches).
[14] *Douglas Shelf Seven Ltd* v. *Co-Operative Wholesale Soc Ltd* [2007] CSOH 53, [606] (Lord Reed).
[15] At [179].
[16] At [181].
[17] At [180].

alternative approach of attempting to assess estimates of damage for each customer;[18] and (iii) it required the estimation of only one counterfactual scenario, which could be established with some certainty and cross-checked against a number of known and available benchmarks. By contrast, estimating separate counterfactuals for each customer was speculative unless a robust assessment of the likely evolution of demand for each individual customer could be performed. Points (ii) and (iii) are particularly noteworthy, as each seems designed to reassure the court that the result would be a sounder and more accurate establishment of the important element of causation of the loss. The attainment of accuracy in counterfactual outcomes is an appealing prospect for any court, as it enables damages awards to be presented as more than mere figures plucked from the air. In assessing the posited counterfactual, Dr Cuchra used as benchmarks factors such as historical sales to the acquired portfolio of customers, the performance of the market for paperboard, and the performance of a control group of comparable but unaffected customers.[19]

The alternative method of evaluating each customer's counterfactual position separately was attacked by Dr Cuchra as severely methodologically flawed for a number of reasons:[20] (i) it could not account for 'cross-customer effects' in the portfolio, in other words linkage of sales to one customer to sales to other customers, and it would both fundamentally contradict economic theory as well as be impossible to do robustly in practice; (ii) from a practical point of view, consideration of individual customers would not produce robust results—the impact of the wrongful act would require to be distinguished from a range of idiosyncratic factors applicable to individual customers; and (iii) such an approach was open to speculation about the exact behaviour and decision-making process of each individual customer. Even the customers themselves might not be able to identify what would happen in the counterfactual scenario.

Having considered the counter-arguments, Lord Drummond Young preferred the portfolio method.[21] In so deciding, he was particularly swayed by arguments about the linkage between customers, by the fact that the portfolio approach (especially where as large a portfolio as possible was selected) tended to cancel out idiosyncratic shocks which affected single customers, and by the impracticability of the individual customer assessment method. As to the latter, he made the important observation that, because, 'according to the evidence, not all customers wished to discuss the decisions that they made, it would I suspect in practice be quite impossible to obtain a comprehensive view of which customers transferred business because of quality problems'.[22] The emphasis on the practicability of the preferred method, and the impracticability of the alternative, is an important one to note for pleaders suggesting possible methods of assessing counterfactual losses.

Lord Drummond Young does not discuss the possibility of abandoning an attempt to assess counterfactual real-world damages and instead using loss of a chance analysis. Such analysis is used where all reasonable attempts to posit a counterfactual outcome produce only an indeterminate answer to the question 'but for *x*, what loss *y* would have resulted?', and it is quite clear from the judgment that such indeterminacy was considered not to arise in the case before the court; on the contrary, the methodology suggested by Tullis Russell was considered to produce a sufficiently determinate outcome for damages for the actual lost goodwill to be assessed.

The approach of Lord Drummond Young to the assessment of damages seems a reasonable one on the facts of the case. Given both the nature of the industry concerned (in which customers communicated frequently with each other, resulting in inter-customer causal linkage of loss), as well as the difficulty of obtaining accurate information from each customer about individual

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[18] This point was used to justify an argument that the portfolio approach gave a more accurate counterfactual outcome: the uncertainty around the counterfactual for a portfolio of customers was lower than the uncertainty around the estimates for individual customers, because idiosyncratic, company-specific factors that led to uncertainty around counterfactual estimates for individual customers were diversified when customers were considered on a portfolio basis, so that such factors tended to offset one another.
[19] At [183].
[20] At [184].
[21] At [217-218].
[22] At [217].

counterfactual outcomes, a method for assessing damages based upon a calculation of the average portfolio figures for lost tonnage multiplied by margin (i.e. net profit) seems, of the two suggested methods, the one likely to have most nearly equated to the actual profits which the pursuers would have made had the defenders not breached their contract, as well as the most practicable method of the two. Any method for calculating losses based upon counterfactual human behaviour (such as decisions whether or not to purchase *A*'s goods rather than competitor *B*'s goods) will inevitably involve a degree of uncertainty,[23] given the inherent unpredictability of human behaviour, but this need not invalidate judicial attempts to adopt that method for assessing damages which seems most successfully to minimise the indeterminate elements inherent in such an exercise. Lord Drummond Young is to be commended for a sensible and practicable approach, though the length of the judgment[24] must serve to remind litigants of the complexity and inevitable expense which will be involved in the proof of damages in large value commercial actions involving trading losses caused to a medium to large customer base. That being said, the judgment is a positive development in the field of damages for harm caused to goodwill. While it rests upon a Scottish legal position which does not recognise a settled distinction between general and special damages, there is no reason why the 'portfolio method' adopted by the court could not be applied in an English contractual claim for general damages due to harm to goodwill.

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[23] As Lord Drummond Young notes in his conclusion on the assessment of damages (at [282]), 'Inevitably, the figures produced by such a methodology are approximate, and I consider it appropriate to adopt a round figure.'
[24] The judgment runs to 319 paragraphs.

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